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EXON-FLORIO REFORM COULD HINDER INVESTMENT TO THE UNITED STATES

Washington—In the wake of the brouhaha over the now defunct Dubai Ports World deal, Congress is considering several bills to tighten the Exon-Florio law to make it easier for the president to block foreign acquisitions of US firms if they impair or threaten to impair national security. A new study released by the Institute for International Economics, *US National Security and Foreign Direct Investment*, concludes that the Exon-Florio process could be improved but that it has nonetheless generally worked quite well over the past 18 years and should not be significantly altered.

During the Exon-Florio period, the interagency Committee on Foreign Investment in the United States (CFIUS) has reviewed hundreds of acquisitions of US firms by foreign investors: Not a single case that has cleared CFIUS subsequently created a major security concern. The CFIUS has recommended that the president block one case, but dozens of transactions have been modified, under CFIUS recommendation, to meet national security concerns, and at least a dozen transactions have been terminated because CFIUS was expected to recommend blocking them.

In light of their analysis of this record, authors Edward M. Graham and David M. Marchick conclude that the bills proposed to modify Exon-Florio, including those introduced by Senator Richard Shelby (R-AL) and Congressman Michael Oxley (R-OH), would do little to enhance US national security and would impose significant new burdens on foreign investors. The net result would be reduced foreign investment in the United States with no additional security benefit. The books shows that foreign direct investment

in the United States brings major net benefits to the nation, so the net effect of the proposed changes would be harmful.

Graham and Marchick show that security concerns over foreign investment in the United States have a long history. Congressional concern surged recently over investment from China, beginning with the takeover of the personal computer operations of IBM by Chinese firm Lenovo. The debate intensified in 2005 with the (subsequently withdrawn) bid by the China National Offshore Oil Corporation to buy US oil firm Unocal. It expanded further in early 2006, when Dubai Ports World bought the port operations of the UK-based Peninsular and Oriental Steam Navigation Company, which would have given Dubai Ports World control of operations at six US ports. Although this transaction easily passed a review by CFIUS, many members of Congress deemed the transaction unacceptable. Consequently, Dubai Ports World agreed to sell its interest in the six US ports.

A number of bills (at last count about 20) have since been introduced in Congress that would modify Exon-Florio, the CFIUS process, or broader foreign investment laws. Several of these bills would clearly hurt the United States and should be rejected. Graham and Marchick argue that the CFIUS process should be improved within the current statutory framework, however, by

- **adding protection of critical infrastructure as a factor for CFIUS consideration.** CFIUS, and particularly the Department of Homeland Security, should clarify how it would protect “critical infrastructure.” Currently, the link between foreign ownership of such infrastructure and national security is unclear.
- **establishing security standards for employment of nonnationals in sensitive positions.** US security agencies can have foreign nationals employed in sensitive positions screened by their own governments or by independent screening agencies operating under the laws of a particular individual’s home country. Doing so would require CFIUS to recognize the validity, through mutual recognition agreements, of background checks undertaken by friendly foreign governments.

- **enhancing disclosure of information to Congress.** CFIUS should enhance the quality and quantity of information provided to Congress on the operation of Exon-Florio. Greater information disclosure should include aggregate rather than detailed, transaction-specific data. Congress should not demand, nor should CFIUS provide, confidential business data that parties to a particular transaction give to CFIUS.
- **clarifying the standard by which CFIUS determines whether there is “foreign control.”** CFIUS agencies should clarify the critical elements of the control test and consider raising the 10 percent threshold of ownership, above which control is presumed.
- **developing international standards for national security review processes.** Members of the Organization for Economic Cooperation and Development, joined by China, India, and Russia, should develop principles that govern laws for national security–related screening processes for foreign investment.

A number of other ideas that have been proposed would chill investment without enhancing national security. Congress and the executive branch should therefore reject them. These include

- **mandatory filings of all foreign acquisitions.** This requirement would completely overwhelm the CFIUS process, force CFIUS to focus on transactions that do not raise national security issues, and divert attention from cases that do.
- **moving the CFIUS chair.** No other US government agency is better equipped to chair the process than the Treasury Department. At the same time, Treasury should defer to security agencies with expertise on particular transactions and should strengthen its own security expertise.
- **introducing an economic security test.** Exon-Florio is perhaps most frequently criticized for not allowing CFIUS and the president to consider economic as opposed to national security issues. Adopting an economic security test would undermine the United States’ long-standing policy of welcoming foreign investment, be extremely difficult to implement, and further politicize the CFIUS process.

The growing discomfort on Capitol Hill has cast doubt on the United States' interest in encouraging foreign investment. Without continued and growing inflows of foreign investment, US manufacturing, employment, competitiveness, and innovation will all be at risk. A major source of financing for the large US current account deficit would be placed at risk. Unless the United States remains open to foreign investment, it will alienate many of its allies and could find itself isolated in an increasingly interdependent world. Maintaining an open environment for foreign investment is deeply in the national security interest of the United States.

About the Authors

Edward M. Graham, senior fellow at the Institute for International Economics since 1990, has also been an adjunct professor at Columbia University since 2002. He was associate professor in the Fuqua School of Business at Duke University (1988–90), associate professor at the University of North Carolina (1983–88), principal administrator of the Planning and Evaluation Unit at the OECD (1981–82), international economist in the Office of International Investment Affairs at the US Treasury (1979–80), and assistant professor at the Massachusetts Institute of Technology (1974–78). He is the author, coauthor, or coeditor of numerous studies, including *Does Foreign Direct Investment Promote Development?* (2005), *Fighting the Wrong Enemy: Antiglobal Activists and Multinational Enterprises* (2000), *Global Corporations and National Governments* (1996), and *Foreign Direct Investment in the United States* with Paul R. Krugman (3d ed. 1995).

David M. Marchick is a partner with Covington & Burling, where he advises US and foreign companies on foreign investment and international trade issues. He is widely recognized as an expert on the Exon-Florio Amendment. Marchick served in the State Department (1993–99) as deputy assistant secretary of state for transportation affairs, deputy assistant secretary of state for trade policy, and principal deputy assistant secretary of commerce for trade development. He has also held trade policy positions at the White House and the Office of the US Trade Representative and is a senior adviser to Kissinger McLarty Associates.

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